

WASHOE COUNTY INVESTMENT COMMITTEE

MINUTES OF MEETING

WEDNESDAY, JULY 26, 2023
3:00 PM

PRESENT: Clara Andriola, Commissioner
Justin Taylor, Treasurer
Eric P. Brown, County Manager
Abbe Yacoben, Chief Financial Officer
Cathy Hill, Comptroller

STAFF: Trenton Ross, Legal Counsel, Washoe County District Attorney's Office
Brenda Mathers, Chief Deputy Treasurer, Washoe County Treasurer's Office
Marissa Kuckhoff, Administrative Assistant I, Washoe County Treasurer's Office
Casey McDonald, Office Assistant II, Washoe County Treasurer's Office (Via Zoom)

FHN: Rick Phillips, President & Chief Investment Officer, FHN Financial Main Street Advisors

OTHER: Robert Andrews, Accounting Manager, Washoe County Comptroller's Department (Via Zoom)
Debra Crowley, Senior Financial Analyst, Truckee River Flood Management (via Zoom)
Samantha Turner, Division Director, Community Services Department (via Zoom)
Robert Beadles (via Zoom)
Lisa Mitchell

The Washoe County Investment Committee met in the Commissioner's Caucus Room of the Washoe County Administration Complex, located at 1001 East Ninth St., Reno, Nevada. Treasurer Justin Taylor called the meeting to order, and Marissa Kuckhoff, Administrative Assistant I, called the roll. It was established that quorum was present, and the Committee conducted the following business.

AGENDA ITEM 2 – PUBLIC COMMENTS [NON-ACTION ITEM]

Agenda Subject: "Comments heard under this item will be limited to three minutes per person and may pertain to matters both on and off the Committee's agenda."

Treasurer Taylor called for any public comment and there was the following.

Robert Beadles stated that he had questions related to Washoe County's investments and FHN. He stated that it appears FHN oversees about \$86 billion with six people, including investment management for \$21 billion in assets, and consulting for another \$65 billion in assets, with zero dedicated analysts. He stated that Phillips and Dazzio are involved in the Government Investment Officer's Association, which might be detracting from the management being done in Washoe County. He said he is concerned that it also looks like the counties FHN manages have similar investments. He said that based on the power point presentation, the County is either \$37 million or \$52 million in the hole. He said FHN calls it an unrealized gain or loss, but it is a loss if you go to sell it right now. He stated that the County had removed all its asset-backed positions in November 2022 liquidating everything and losing the County money. He concluded his comments with the first rule of investing is to make money.

AGENDA ITEM 3 – MINUTES [FOR POSSIBLE ACTION]

Agenda Subject: "Possible approval of minutes for the Washoe County Investment Committee's May 3, 2023, meeting. Board members may identify any additions or corrections to the draft minutes as transcribed."

Treasurer Taylor introduced this agenda item, called for any corrections, and there were none. Chief Financial Officer Abbe Yacoben moved to approve the minutes and Comptroller Cathy Hill seconded. The motion passed unanimously.

AGENDA ITEM 4 – POSSIBLE ACTION TO RECOMMEND THE WASHOE COUNTY BOARD OF COUNTY COMMISSIONERS APPROVE UPDATES MADE TO THE WASHOE COUNTY INVESTMENT POLICIES. THE WASHOE COUNTY INVESTMENT COMMITTEE PREVIOUSLY ADOPTED THE CHANGES ON MAY 3, 2023. APPROVED UPDATES INCLUDED:

- **ADD ‘COMPREHENSIVE’ TO COUNTY’S ANNUAL FINANCIAL REPORT.**
- **UPDATE OF LANGUAGE TO “PRUDENT PERSON” PER NRS 355.140.**
- **ADD ‘AND AS NRS ALLOWS’ TO “THE INVESTMENT OFFICERS SHALL TAKE CARE TO MAINTAIN A PRUDENT BALANCE OF INVESTMENT TYPES AND MATURITIES AS THE COUNTY’S INVESTMENT STRATEGY DICTATES”.**
- **CAPITALIZATION OF INVESTMENT MANAGEMENT PLAN.**

Treasurer Taylor introduced this agenda item and reviewed the updates to the Washoe County Investment Policy adopted by the Investment Committee on May 3, 2023. Chief Financial Officer Yacoben motioned to recommend the Washoe County Board of County Commissioners approve the updates, Comptroller Hill seconded the motion, and it passed unanimously.

AGENDA ITEM 5 – UPDATE AND DISCUSSION REGARDING WASHOE COUNTY’S INVESTMENT PORTFOLIO [NON-ACTION ITEM]

Agenda Subject: “The April-June 2023 quarterly report will be provided, and Committee Members may discuss the report. Presentation by FHN Financial Main Street Advisors on the following: Washoe County’s Investment Portfolio Strategy discussion and Economic Update.”

Treasurer Taylor introduced this agenda item and Rick Phillips with FHN presented the quarterly report.

Phillips gave background for himself and FHN. He started managing public fund portfolios in 1989 for about eight years with the City of Las Vegas, then managed funds for Clark County for another eight years, and then twenty plus years ago started his own firm, FHN. There are six FHN employees in Las Vegas and they are part of the fortieth largest bank in the Country so there are additional strategists and economists throughout the Country. They oversee about a hundred billion dollars for state and local governments and much of what they do for the County is controlled by Nevada Revised Statutes and the Investment Policy.

ECONOMIC AND MARKET UPDATE

Phillips gave an economic overview of the market.

12 Paramount Principles of Public Fund Investment Programs

1. Longer Duration Will Generate More Investment Income Over the Long Run
2. A Detailed Asset/Liability Matching Model (aka: Cash Flow Model) is a Must
3. Interest Rate Risk (WAM/Duration) Should Match Cash Flow Metrics
4. Credit Can Enhance Income, But Duration is the Bigger Determinant of Income
5. Prudent Diversification Among Asset Classes and Investment Types/Maturities
6. You, I...Nor Anyone Else Can Time the Market Accurately Over the Long Run
7. Limit Optionality (Callables) in the Portfolio
8. The Goofiness of GASB 31—Gains are Bad and Losses are Good! (The Unrealized Kind)

9. Understand the Risks of Funds in LGIP and Other Pools (JPAs, Bond Funds)
10. Follow GAAP (Generally Accepted Accounting Principles)
11. Benchmark Your Investment Program and Portfolio in Multiple Ways
12. Tell the Story: Provide Quality, Timely, Transparent Reporting

Probabilistic Expectations:

Increasing the likelihood of long-term success for the Investment Program (SLI-Safety, Liquidity, Income).

Comparison: Clark Co Pool (2Y WAM) vs. California LAIF (.7Y WAM)

$\$3.52\text{Bil Avg Bal} \times .46\% = \$16.2\text{Mil} / \text{Yr} \times 25 \text{ Years} = \404.8Mil

Phillips showed a graph comparing the Clark County Investment Pool and the California LAIF and explained that the longer duration core has generated more income for the County.

Fed Funds

Phillips showed a graph of the average Fed Funds from 1955 to present and the average was 4.90%. He explained that there has been the largest YOY percent change in history and that while the Fed had said in January 2022 that they were going to hike three times, they have actually hiked 21 times. The current Fed Funds Rate is 5.25-5.50%.

US 10 Year Yields (1790 to Present)

Phillips reviewed a data set from 1790 through present showing the fluctuations of the US 10 Year Yields. Lower inflation factors: debt, demographics, globalization, and technology.

Banks vs. Public Funds

Phillips explained that a few banks went under this year and that banks are very different from public fund portfolios. When rates go up, unrealized losses are generated in the portfolio. When rates go down, unrealized gains are generated in the portfolio. When rates went down during COVID, banks had their largest unrealized gains, similar to the County's portfolio at the time. Then this last year, rates went up faster than ever before, and banks had unrealized losses on their portfolios. Bank deposits are on demand, which was the problem for the Silicon Valley Bank because tech investors were worried and took their money above the FDIC limit out and that caused the run on the bank. The Local Government Investment Pool is run at a much shorter maturity because those deposits are on demand. Knowing the cyclical nature of the Pool alleviates some concern when there are unrealized losses and unrealized gains. Phillips stated that having a small unrealized loss can be preferable because that means interest rates have gone up.

Chief Financial Officer Yacoben made a comment that one of the reasons they do not focus heavily on this is that the Treasurer's Office staff works closely with FHN on cash flow needs so that the County is able to hold investments to maturity.

What's Ahead for Fed Funds

Phillips said they are predicting 5'ish cuts to December 2024.

Portfolio Balances by Month by Fiscal Year

Phillips showed a graph representing the Historical Book Values Per Fiscal Year for FY2019 through FY2023 and explained the cyclical nature of the County's portfolio.

Drawdowns Drive Cash Flow Metrics and WAM/Duration

Phillips explained that property tax collection in July drives the investment pool average balance up, and February through July drops the average balance.

A Big ROC (Rate of Change) Change!

Phillips looked at the Portfolio's balance over time from 2016 through May 2023, and said there is an increase each July and a decrease from February to July. How much liquidity the County needs corresponds to how much the County's portfolio will drop. Phillips explained that part of their strategy is to acquire bonds with maturities that meet the County's liquidity needs to avoid selling at a loss.

Probabilities: What May Be Ahead or "Rhyme" for the Economy Markets

Hard Landing – ISM Manufacturing, Inverted Yield Curve, Leading Econ Index, Commercial Real Estate

Soft Landing – GDP, Inflation, Consumer Spending, Banks, Credit Spreads, Housing, ISM Services

No Landing – Stock market, employment, travel

Economic "Landings"

Historical Examples of Soft Landings

Historically, the Fed has never been able to achieve a soft landing when its policies have significantly pushed up unemployment. This notion has even been codified in what's known as the Sahm Rule, which states that a recession occurs whenever the three-month moving average of the national unemployment rate rises by 0.5 percentage points or more relative to its low over the preceding 12 months. Sources: bls.gov, stlouisfed.org

According to The Washington Post, over the last 75 years, every time the unemployment rate has moved up by half a percentage point or more, it has resulted in a full-blown recession. In his March 2022 news conference, Fed Chairman Jerome Powell cited three times that the Fed has been able to successfully create a soft landing—1964, 1984, and 1993—and in each case, the unemployment rate stayed low despite the Fed increasing the federal funds rate.

- 1964: In October 1964, the federal funds rate was at 3.4% but by November 1966 it was at 5.8%, however, during that period the unemployment rate declined from 5.1% to 3.6%.
- 1984: In February 1984, the federal funds rate was at 9.6% and it rose to 11.6% by August of that year, however, the unemployment rate dropped from 7.8% to 7.5%.
- 1993: In December 1993 the federal funds rate was at 3% but by April 1995 it stood at 6%, however, during that same period, unemployment dropped from 6.5% to 5.8%.

Historical Examples of Hard Landings

The most recent example of a hard landing in the U.S. was in 2007 when the Fed tightened monetary policy to try to cool the residential real estate market which was experiencing a speculative housing bubble. This contributed to the Great Recession. In each of the years 1970, 1974, 1980, 1990, and 2008, inflation was running higher than 5%, and in each of those years, Fed policy led to a recession.

No Landing: Stocks

Phillips explained that the S&P 500 Index is within 5% (now 3%) of the all-time high and there was a 25% increase since the October 2022 low. The S&P doesn't usually have trouble until the Fed Cuts. Stocks Buyers have benefitted from the Fed's and Uncle Sam's liquidity injections.

No Landing: Unemployment Rate Near All-Time Low

The current rate is 3.6%, low this cycle was 3.4%, and the Fed's target is 4%. The all-time low was 2.5%

immediately after WW2. The number of job openings is approximately two openings per unemployed and there has been above 200k job growth for 30 consecutive months.

No Landing: TSA Checkpoint Travelers

The all-time high for TSA checkpoint travelers was July 4th. Prior to that, it was Thanksgiving travel of 2019. Consumers are spending money on travel.

Soft Landing: GDP and Inflation

YOY Growth (GDP) and inflation are slowing. GDP is forecasted to stay positive. YOY CPI expected to be in the 2s in 2024. Phillips explained the inverted yield curve means shorter-term rates are more correlated with Fed Policy, and longer-term rates are more correlated with growth/inflation expectations.

Inverted Yield Curve: 250+ Days

How long until the recession? When the 10Yr/3M U.S. Treasury Curve Inverts 5 consecutive trading days. At this time, the yield curve has been inverted for 255 consecutive trading days.

Soft Landing: Consumer Spending

Phillips explained that consumer spending comprises about 70% of the US economy. Spending is still elevated, and spending is slightly negative on Real YOY Basis.

Soft Landing: Banks

Bank Run on deposits has stabilized. Despite the run, deposits are still elevated. Banks are tightening lending standards. Bank profitability should continue to be challenged with an inverted Yield Curve.

Soft Landing: Credit Spreads

Credit Spreads widened during the banking crisis but have declined. Tightening lending should put upward pressure on the spreads in the future. Reminder: The Fed purchased Corp Bonds, including junk, during COVID.

Soft Landing: Housing

Housing prices on a YOY basis are close to flat. About 60% of mortgages are 4% or below. Pre-COVID buyers have a bunch of equity. Supply constraints should soften price declines. \$375k was the average home price pre-COVID, and that is now at \$552K (down 6%). Phillips reported that about 40% of homes do not have a mortgage.

Soft and Hard Landing: Institute of Supply Management (ISM)

Diffusion Indexes: Above 50 – Expanding, below 50 contracting. Services are about 70% of the US economy. There is a divergence between services and manufacturing. Fed hikes usually lead to sentiment declines.

Hard Landing: LEI (Leading Economic Index)

Prints below -5% have always preceded a recession. We are below -5 now.

Fed's Mandates: Full Employment and Stable Prices and... It's Prices Now!

The Fed's monetary policy actions are guided by the mandate to promote maximum employment and price—and stable prices for the American people. "My colleagues and I are acutely aware that high inflation imposes hardship, as it erodes purchasing power, especially for those least able to meet the higher costs of essentials like food, housing, and transportation. We are highly attentive to the risks that high inflation poses to both sides of our mandate, and we're strongly committed to returning inflation to our 2 percent objective."

Phillips provided information from Fortune which said that 57% of Americans can't afford a \$1,000 emergency expense, and 68% of people are worried they wouldn't be able to cover living expenses for a month if they lost their primary income source.

Soft Landing: Inflation

Phillips explained that "easy" declines of inflation are most likely behind us. After June's CPI, YOY Comps get much tougher. CPI YOY will probably be sticky in the 3s. Energy prices have helped overall CPI drop materially.

Will Sticky Wages Cause the Fed to be More Hawkish?

Phillips showed CPI YOY and Wages YOY tracked over time and explained that they are generally correlated, but for the last twenty months there have been negative wages when you factor in inflation. The Fed does not want to have wage push inflation and they have projected unemployment to go up as they have tightened financial conditions by raising rates.

Hard Landing: Yield Curve

An inverted yield curve has predicted 8 of the past 8 recessions. The yield curve is the most inverted since the early 1980s.

Treasury Rates/Fed Funds Since the Start of 2022

Phillips looked at interest rates over 2022 and explained that short rates are correlated with the Fed.

PORTFOLIO METRICS AND INFORMATION

Portfolio Summary

The three main objectives of the portfolio are safety, liquidity, and income. Phillips reviewed information as of June 30, 2023, for the Sector Allocation, Maturity Distribution, Credit Quality, Account Summary, Month-End Portfolio Book Yield, and Top Issuers. The maturity distribution is weighted mostly in the 0-1Year (34%), followed by the 1-2Year (22.6%), and 4-5Year at 20.9%. Phillips explained that locking in longer duration maturities is important when Fed cuts are expected as they are next year. Phillips also explained that there is an unrealized loss of \$41 million, the highest it has ever been, because interest rates moved faster than ever seen before. Bonds are bought to hold and have a maturity date. The sector allocation is regulated by Nevada Revised Statute.

Investment Policy Compliance

The Washoe County Portfolio is in compliance with Nevada Revised Statutes and the Investment Policy.

Historical Earning & Book Return Performance

The fiscal year-to-date earnings and the fiscal year-to-date book return were shown by month.

Treasurer Taylor thanked Phillips for the report and moved to the next agenda item.

AGENDA ITEM 6 – COMMITTEE MEMBER COMMENTS [NON-ACTION ITEM]

Agenda Subject: "This item is limited to announcements or issues proposed for future agendas and/or workshops."

Treasurer Taylor called for any committee member's comments.

Treasurer Taylor thanked Phillips for his explanation of unrealized losses.

County Manager Brown thanked Phillips for the presentation and said that given the outlook, the County will likely take a conservative posture on how funds are spent in the near term.

AGENDA ITEM 7 – PUBLIC COMMENTS [NON-ACTION ITEM]

Agenda Subject: “Comments heard under this item will be limited to three minutes per person and may pertain to matters both on and off the Committee’s agenda.”

Treasurer Taylor called for public comment and there was the following.

Robert Beadles said that he was surprised there were no more questions from the board and that the presentation sounded like excuses. He said that unrealized losses are realized if you sell, and the first rule of investing is to make money. He stated that it does not appear that FHN is doing research as to how the counties should invest their funds. He said that it was not clear in the presentation if the Q3 and Q4 information was projection. He asked if there was an audit process outside of FHN to ensure accurate reporting.

AGENDA ITEM 8 – ADJOURNMENT [NON-ACTION ITEM]

Treasurer Taylor adjourned the meeting.

Attachments to Minutes



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Agenda Item 5 -
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Pending Approval